Values and Land Value Capture

At the Lincoln Institute of Land Policy, our activity centers on policy-relevant research and training. We are nonpartisan, and our work defaults to objective and evidence-based analysis. We pose questions and test hypotheses that can be answered empirically—through dispassionate inquiry and defensible methodology yielding results supported by data. We do not espouse or advocate for a particular ideology.

We are mindful, however, that many policy decisions hinge on normative principles, not dispassionate analysis. And sometimes, especially when land is involved, conflicts arise at the level of principle. At the Lincoln Institute, we are not unwilling to take principle-based positions. Our work has always been driven by an objective economic analysis of land markets and a principled position regarding the just deserts of land ownership.

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Because the supply of land is fixed, demand determines its price. As such, landowners enjoy monopoly power and garner the full amount of price increases generated by higher demand. And over time, demand for land tends to increase. Because landowners do nothing to "earn" the windfalls of price appreciation, many economists and philosophers have considered them ill-gotten gains. This is best expressed by John Stuart Mill in *Principles of Political Economy* (1848):

> The ordinary progress of a society which increases in wealth, is at all times tending to augment the incomes of landlords; to give them both a greater amount and a greater proportion of the wealth of the community, independently of any trouble or outlay incurred by themselves. They grow richer, as it were in their sleep, without working, risking, or economizing. What claim have they, on the general principle of social justice, to this accession of riches? In what would they have been wronged if society had, from the beginning, reserved the right of taxing the spontaneous increase of rent, to the highest amount required by financial exigencies?

This normative view is also fundamental to arguments put forth by Henry George in his most famous work, *Progress and Poverty* (1879). He asserted that it was unfair and inefficient to distribute unearned financial benefits to idle landowners while taxing the incomes of productive labor and entrepreneurs. He considered it a form of slavery that reduced economic growth and generated persistent poverty. George proposed taxing away this unearned land value to support the functions of government and to eradicate the poverty that accompanied the unparalleled opulence produced by the Industrial Revolution.

With some additional nuance, our recent work around land value capture emerges from a similar analysis of the market value of land and a normative view of the just deserts of land ownership. Land value capture is based on the notion that the public is entitled to all, or a portion of, land value increases that result from public investment in land improvements or public actions that increase land value. If a municipality pays for roads, sewers, or public transportation that increase the value of proximate land, the municipality is entitled to recoup some, or all, of this increased value from landowners or developers. Similarly, if a city rezones a neighborhood to permit more dense development, the city is entitled to a share of the resulting land value increase. This recompense is predicated on a basic principle: those responsible for creating value should reap some, if not all, of the benefits.

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Today, some form of land value capture is practiced almost everywhere. Some Latin American cities treat development rights as a privilege and auction them in public markets. The cities limit "as-of-right" development for landowners at a low level—at one floor area ratio (FAR), for example. Anyone planning to build above one FAR would need to buy a certificate for each proposed square meter up to the maximum allowed FAR set in the city's master plan for the land. The proceeds from sales of the certificates pay for transit lines, public parks, or affordable housing. In many other cities around the world, developers are required to offer shares of new housing units at below-market rates through mandatory or voluntary inclusionary housing programs. In other places, special assessments, or betterment contributions, are imposed on landowners to pay for new sidewalks, curbs, or publicly supported façade improvements.

These programs begin with acceptance of the idea that the value of land is determined by many forces that are unrelated to an owner's efforts or control. They also are grounded on ethical principles of fairness—who gets

The Bridge of Commons (Puente del Común) near Bogotá, Colombia, was financed in 1809 with betterment contributions, a form of value capture. Credit: Klaus Lang / Alamy Stock Photo what and why. But they often run counter to arguments rooted in other basic principles that undergird constitutional law, namely property rights. Those adhering to a narrow view of private property rights might argue that all land value belongs to the owner, regardless of its provenance. According to this view, any attempt by the government to claim even a portion of land value increases would constitute a "taking," which violates constitutional protections of private property. In the end, such principle-based debates are weighed and settled in the courts.

In Latin America, the courts have defended the sale of development rights against claims of property rights abridgement and illegal "takings" by the state. This defense was founded on establishing a clear definition of the rights that landowners acquire when they take possession of land. In essence, owners are not allowed to develop their property in any way they desire. They are permitted to build to a specific density, consistent with a master plan, using prescribed materials and adhering to design standards, described in building codes. The courts decided that since development rights were permitted by the state and conveyed from the state to the landowner, they were not property rights *per se*. Since they were something that landowners did not possess, they could not be taken from them. Similarly, inclusionary zoning and other forms of value capture have survived constitutional challenges in other countries and U.S. states.

With the exception of formal value capture tools that auction development rights, most value capture mechanisms are ad hoc—negotiated on a deal-by-deal basis with landowners and developers. This is because the actual increase in land value associated with public action is hard to observe or measure. A number of researchers have created tools that can be used to estimate value increases and convert them to specific outcomes, like the number of inclusionary housing units that one could reasonably expect given the financial details of a development project. But these tools are infrequently used to guide negotiations.

In the coming two to three decades, the world will confront the tremendous challenge of accommodating the billions of new residents expected to migrate to cities around the globe. This will require significant investments in new infrastructure—for transit systems, water and septic services, and housing. At the same time, the world will need to address its penchant for deferring costly maintenance of existing critical infrastructure. All in, this will require an annual global investment of $5 to 6 trillion (USD). Without magical new sources of revenue to cover these outlays, many cities and countries are casting around for ideas, and many are finding the answer in land value capture. In nascent formal efforts to compare expenditures on basic infrastructure and land value increases in Latin America, we've seen total land value increases exceeding infrastructure investments by a factor of six. In other words, capturing around 16 percent of land value increases in these cases would repay the full infrastructure investment.

These limited experiments are indicative, but not definitive. For our part at the Lincoln Institute, we recognize the need to deepen our understanding of the intricacies of land value capture and its potential to close infrastructure finance gaps. In the coming weeks, we will launch a new global value capture campaign. We will document the legislative processes that enable land value capture and legal defenses to constitutional challenges. We will study the methods used to determine the value of land before and after public improvements are made. We will document the share of land value increases than can be captured through various instruments. And we will consider the potential unintended consequences of using land value capture as a major public finance tool.

Land policy making, at its best, is a principled discourse driven by facts and grounded in principles. At the Lincoln Institute, we are comfortable with the principle that those who create value deserve at least a share of that value. Studying and spreading the use of tools that capture publicly created land value for public purposes brings us back to our roots.